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¶1. (U) Summary. This is Volume 8, issue 39 of U.S. Embassy
Pretoria's South Africa Economic News Weekly Newsletter.

Topics of this week's newsletter are:
- Economic Policies Expected to Remain
  Consistent under Mothlanthe
- Record CPIX Increase in August
- Fears of Retail Recession Increase
- Ford and GM to Reduce SA Workforce
- BMW to Announce 3-Series Production
- Eskom Walks Timing and Funding Tightrope
  as Nuclear Decision Nears
- Eskom Considers Other Power Stations
  and Renewable Energy
- PetroSA's Coega Refinery May Treat
  Venezuelan Heavy Crude
- Political Change Could Deter Telkom Plans
- SAG to Appeal Court Ruling and Pursue
  "Managed Liberalization"
- Trump Enters SA Market
- SA and Brazil to Improve Air Connections
- Nationwide to Enter Full Liquidation
End Summary.

Economic Policies Expected to Remain
Consistent under Mothlanthe

¶2. (U) Newly elected President Kgalema Motlanthe moved quickly to reassure South Africa and the world that there would be no policy changes by his new interim administration. "Mine is not the desire to deviate from what is working. It is not for me to reinvent policy. Nor do I intend to reshape either cabinet or the public service," Motlanthe emphasized. On economic policy, ANC president Zuma also confirmed that "economic policies will remain stable, progressive and unchanged", which is in line with industry analysts' belief that there will not be any dramatic policy shifts in the coming weeks. However, some policies such as inflation targeting are already under the spotlight and are likely to be reviewed after the 2009 elections. A number of cabinet ministers, including Finance Minister Manuel, resigned on September 23 in a show of respect for ousted President Thabo Mbeki. Manuel's resignation took the markets by surprise, with the rand plummeting 2.5% and the yield on 2015 government bonds surging by 20 basis-points to 9.12%.

However, some market recovery occurred after Manuel confirmed that he was willing to serve in the new administration. The rand also gained ground against most major currencies, particularly against the dollar because of turmoil in the U.S. banking and financial sector, after Motlanthe was sworn-in on September 25. On the future of fiscal policy, Manuel said that significant changes to the budget are unlikely and that economic policies decided upon at the ANC Conference at the end of 2007 continued to inform a number of issues. Manuel added that the release of the Medium Term Budget Policy Statement was proceeding according to plan and would be released on October 21. ABSA Capital expects continued rand volatility and some weakness on domestic developments, but that weakness is likely to be tempered by international market developments and the potential for large foreign direct investment inflows in coming weeks. (ABSA Capital and Business Day, September 25-26, 2008)

Record CPIX Increase in August

¶3. (U) South Africa's targeted consumer price index inflation (CPIX) jumped from 13.0% in July to a record 13.6% y/y in August. The Qjumped from 13.0% in July to a record 13.6% y/y in August. The increase beat forecasts and is clouding the interest rate outlook in South Africa. Food, fuel, and electricity price increases were once again the main drivers of CPIX inflation, with the rise in the food component accelerating from 18.5% in July to 19.2% y/y in August. The shift in the property tax survey from July to August, which was based on new property valuations in many metropolitan areas, also added to inflationary pressures. The South African Reserve Bank (SARB) had previously predicted that CPIX would peak at an average 13% in the third quarter of 2008. SARB Governor Tito Mboweni now believes that inflation will remain higher than expected, despite changes to the consumer price basket which go into effect next year.

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"Our simulations indicate inflation will still be higher than expected," Mboweni noted. He did not expect inflation to reach the targeted 3-6% band until the second quarter of 2010. The SARB's Monetary Policy Committee (MPC) has raised interest rates by 500 basis points since June 2006 in attempts to bring CPIX back down to the targeted band. However, the MPC left the key repo rate unchanged at 12% last month, citing an improved long-term inflation outlook. Analysts believe the SARB will leave the interest rate unchanged for the remainder of the year, with possible interest rate cuts in 2009 as the impact of base effects and changes in the consumer price basket become clearer. (ABSA Capital and Engineering News, September 23, 2008)

Fears of Retail Recession Increase

¶4. (U) Retail sales fell 4.6% in July compared with the same month last year. This is the sharpest annual fall since records began a decade ago, fanning fears that the sector is sliding into a recession. Soaring inflation, the rising cost of debt, and a sharp slowdown in the growth of disposable income has curbed consumer spending, the economy's main growth engine since 2006. "Growth in real retail sales has been in negative territory for three consecutive months, setting the scene for a recession in the sector," said Standard Bank Economist Johan Botha. "The outlook remains poor over the medium term ... retailers are not only suffering falling demand but also rising input costs, which have consistently impacted on profitability," he added. Analysts predicted that things would get worse before they got better. Investec Economist Annabel Bishop explained that retail sales growth could tentatively turn positive in the second quarter of 2009 and then strengthen during the year if lower inflation and interest rate cuts materialize as expected. Retail and wholesale sales are the economy's third-biggest sector, making up about 14% of gross domestic product. (Business Day, September 25, 2008)

Ford and GM to Reduce SA Workforce

¶5. (U) Ford Motor Company South Africa and General Motors South Africa (GMSA) are set to reduce total workforce due to weak sales expectations throughout 2008 and into 2009. Ford has cited increasingly difficult macro-economic pressures, including high interest and inflations rates for the reduction. The rapid devaluation of the rand earlier this year also challenged the industry by increasing the cost of imported components. The rand devalued by 29% against the euro and 22% against the yen in the first three months of 2008. GMSA African Operations President Steve Koch emphasized that if the rand continued to devalue against the major currencies, it would put "a lot of pressure on producing cars in South Africa." GMSA will reduce its workforce by 1,000 people by the end of December 2008. Kock said it "is a significant move and we'll be at a cost competitive level in terms of our local manufacturing," after the reduction. Both companies will attempt to achieve the workforce reduction through voluntary separation Qachieve the workforce reduction through voluntary separation packages. Kock emphasized that the South African automotive industry had to improve the cost-competiveness of materials as well if it was to have any chance of growing the domestic sector as it needed to. At current productivity levels, material costs to build an Isuzu pick-up at GM's South Africa plant are about 30% to 40% higher than the cost to produce the same vehicle in Thailand. Material costs accounted for more than 80% of the cost of building a vehicle in South Africa since a significant portion of inputs are imported. South Africa tends to produce in low volumes and the lack of skilled employees also adds to the bill. Koch explained that high material costs can be reduced by higher-volume local production and closer alliances between components and vehicle manufacturers - both of which are proposed by government's new Automotive Production Development Program (APDP) which is set to replace the Motor Industry Development Program (MIDP) that expires in 2012. (Business Report and Engineering News, September 12-15, 2008)

BMW to Announce 3-Series Production

¶6. (U) BMW has agreed in principle to build its next 3-Series sedan

in South Africa, following the unveiling of the government's new Automotive Production & Development Program (APDP) support scheme for the motor industry. BMW Chairman Norbert Reithofer explained that the final decision is contingent upon the signing of a memorandum of understanding (MOU) that confirms the terms of the new APDP. Details of the APDP still have to be finalized and it will be approved only in mid-2009. During a visit to South Africa in early September, Reithofer announced that President Thabo Mbeki and Department of Trade & Industry (DTI) Minister Mandisi Mpahlwa had promised the MOU guaranteeing investment terms. The main provisions of APDP are due to start in 2013, but some investment rules will begin changing in 2009. Reithofer explained that a decision on global production of the next 3-Series should have been made months ago but was postponed because of South Africa's delay in announcing the details of the APDP program. He is now "comfortable" with the new program. The next 3-Series sedan is due to go into production in Germany in 2011. If BMW South Africa wins approval, South African production would probably start in 2012. Reithofer said the preference was for three plants - two in Germany and one in South Africa - to meet all export demand. BMW's Rosslyn plant builds 53,000 vehicles a year, 80% of which are exported. The U.S. is the main destination due to the Africa Growth and Opportunity Act (AGOA), which allows South African cars to land there duty-free. A positive BMW decision would be a major boost for the APDP at a time when industry representatives have asserted that the DTI goal to build 1.2 million vehicles annually by 2020 is "visionary but probably unrealistic". SA automobile and automobile parts exports were over $1 billion during the first six months of 2008. (Financial Mail, September 12, 2008)

Eskom Walks Timing and Funding Tightrope
as Nuclear Decision Nears

¶7. (U) State-owned power utility Eskom is said to be on the cusp of making a decision on what would be its largest-ever single investment, the development of the Nuclear-1 project , but serious questions are being raised about funding and timing of the project. Concerns regarding growing international financial-market turmoil, the current overheated nature of the supply sector, and recent domestic political turmoil could delay the project. The power-stretched, cash-stressed utility is currently evaluating bids for the proposed nuclear power station from two pressure water reactor (PWR) vendors, one from the so-called EPR Consortium, led by Areva of France, and another from the N-Powerment Consortium led by Toshiba's Westinghouse, of the U.S. Eskom is keen to pursue a nuclear option as a way of diversifying its carbon-emission-heavy coal base. It has indicated that up to 50% of a 40,000 MW capacity expansion between now and 2025 would be based primarily on PWR technology. However, the funding of Nuclear-1, and any subsequent 'fleet plan', will be challenging. No details have emerged about the precise capital requirement for the initial 3,000 MW, but Qthe precise capital requirement for the initial 3,000 MW, but figures of up to R150 billion ($20 billion) have been mooted. Eskom's strained financial position causes such a hefty nuclear price tag to pose a serious dilemma for a utility that has already hinted at a funding gap for its five-year R343 billion ($50 billion) capital program, which would only include initial nuclear-related capex. Adding to the quandary is the fact that Eskom is going to have to approach the foreign and domestic capital markets in the midst of what is arguably the globe's biggest financial crisis since World War II. Further, Eskom has to do this against the backdrop of having been downgraded by Moody's and Standard & Poor's, with further downgrades possible from Fitch Ratings, which has not yet pronounced on Eskom's rating despite announcing negative outlooks earlier in the year. Eskom could need to raise as much as R90 billion ($ 11 billion) offshore, to accelerate the development of some 17,000 MW of new capacity by 2017, despite a plan to maximize local borrowings. In addition, it will have to begin approaching the capital markets before the year is out and following the recent resignation of its Financial Director Bongani Nqwababa. Industry observers note that it will still be important to make a timely decision to gain a spot in the production queue with either Westinghouse or Areva. (Engineering News and Business Day, September 18-22, 2008)

Eskom Considers Other Power Stations
and Renewable Energy

¶8. (U) State-owned power utility Eskom said it was "about to start" with environmental impact assessments for "possible further coal-fired power stations" with up to 5,400 MW capacity in the Waterburg and Vaal areas in the Limpopo and Northern Cape Provinces. Construction of the 4,788 MW Medupi coal-fired power plant in Limpopo and the 4,818 MW Kusile plant in Mpumalanga Province are already underway. Eskom's Tony Stott said Eskom required additional base load capacity beyond the two plants already under construction. He said it was premature to indentify the exact size of new power stations yet to complete pre-feasibility studies. Eskom is also considering a concentrated solar power (CSP) plant or solar thermal plant at Upington in the Northern Cape. Eskom Corporate Services Head Steve Lennon said Eskom supported finding competitive commercial solutions involving renewable energy. Department of Minerals and Energy (DME) Chief Nuclear Director Tseliso Maqubela said the energy-pressed status quo did not mean South Africa would go nuclear or bust. He admitted that Eskom and authorities may not have paid enough attention to renewable energy. (Mail and Guardian and Business Day, September 19, 25, 2008)

PetroSA's Coega Refinery May Treat
Venezuelan Heavy Crude

¶9. (U) PetroSA Vice President of New Ventures Jorn Falbe said last

week that PetroSA's proposed $11 billion Coega oil refinery project was the last opportunity for SA to build a refinery that would concentrate on handling heavy crude supplies from the Atlantic region to maximize economic returns. Such a refinery would source its crude from Venezuela, Brazil and Angola, reducing SA's traditional reliance on light sweet crude from the Middle East. This statement follows Venezuelan President Chavez recent visit to SA on September 2-3, which sparked renewed interest in the project. Chavez is believed to have an interest in the project as a means of both increasing the market for Venezuelan heavy crude and reducing Venezuela's dependence on the U.S. market for the same crude. Falbe said that, contrary to perceptions, the refinery would not be reliant on oil supplies promised by Chavez during his visit, since it could also count on potential supplies from Brazil and Angola, which have similar heavy crude deposits. A mission from SA will visit Venezuela during the week of September 22 to look into the possibilities of crude oil exploration (most probably in the Orinoco Belt) while a Venezuelan team will visit SA during the same period to look into the details of the proposed refinery and the use of bulk state-owned storage facilities at Saldanha Bay on the west coast.

¶10. (U) Falbe said the next six months would be critical for the refinery project as it moves into the front-end engineer-ing and design (FEED) phase. HSBC has been appointed as a financial advisor for the project and the pre-feasibility study has been completed by the KBR global engineering, construction and services company. The next step will be to select and engineering partner to complete the Qnext step will be to select and engineering partner to complete the FEED study. PetroSA began with 30 potential partners and has reduced this number to four unidentified "global players". A final decision on the project will be made after the completion of the FEED study. Falbe said PetroSA found itself in the same position that state power company Eskom did a few years ago when the SAG declined to commit to major investments in the electric power sector. The implication is that if the SAG does not finance the project, SA will suffer refined product shortages or have to import these [products. Falbe said that the refinery would be strategically placed to serve the rapidly growing Chinese and Indian markets and that the opportunity to build the refinery was "now or never". Minister for Public Enterprises Alec Erwin was reportedly committed to drive this refinery project forward, but he submitted his resignation on September 23, following the unexpected resignation of President Mbeki on September 20. (Business Day, September 15, 2008)

Political Change Could
Deter Telkom Plans

¶11. (U) State-controlled ICT Company Telkom is preparing for the expected shedding of its 50% stake in Vodacom by crafting plans to

offer mobile services of its own. By the end of the month, the fixed-line phone company will be rolling out a wireless network promising high-speed internet access and the ability to make voice calls using mobile phones. Telkom needs to devise a new mobile strategy because its partial-ownership of Vodacom has never translated into a successful working partnership. Telkom is now negotiating to sell 12.5% to Vodacom's other owner, UK-based Vodafone, for R18.75 billion ($2.3 billion). Telkom will also unbundle the remaining 37.5% stake to Telkom shareholders. The flaw in that plan is that it leaves Telkom without a mobile partner when clients are demanding a combination of fixed and mobile services. However, one source believes the change of power sweeping through the African National Congress (ANC) will scupper Telkom's plan to sell the Vodacom shares to Vodafone. That is unlikely to happen, he believes, as the state would struggle to justify selling the control of such a valuable asset to a foreign entity. Whether the government agrees to sell Vodacom or not, the ongoing changes in the government could stall any decisions for several more weeks, the source says. "I don't see Telkom coming up with something magical," he said. "Unless Telkom can say 'this is our new mobile strategy', I see no logical explanation to sell Vodacom. It doesn't make sense

for South Africa to sell that asset to a UK company." The counter-argument is that Telkom and Vodacom have never worked well together. Telkom CEO Reuben September recently said the SAG and Vodafone's dual ownership of Vodacom was bedeviling all three parties, and was not helping Telkom to grow its business. (Business Day, September 25, 2008)

SAG to Appeal Court Ruling and Pursue "Managed Liberalization"

¶12. (U) Department of Communications (DOC) Minister Dr. Ivy Matsepe-Casaburri announced that she would appeal the Pretoria High Court's August judgment, which ruled that ICT service provider Altech had the right to convert its existing value-added network service (VANS) license into an individual-electronic communications network service (I-ECNS) license. The ruling gave Altech and other VANS the right to develop and operate their own communications network, previously the preserve of large industry players such as Telkom, Neotel, Vodacom, and MTN. However, Matsepe-Casaburri asserted that the government's "managed liberalization" policy would be seriously undermined if VANS licensees were allowed to obtain I-ECNS licenses under the current license conversion process. DOC will issue a policy directive to the Independent Communication Authority of South Africa (ICASA) empowering ICASA to implement an invitation-only application process for a number of new I-ECNS licensees in accordance with the managed-liberalization policy. The DOC is also expected to expedite an amendment to the Electronic Communications Act to remove any ambiguity around managed liberalization, and to clarify that VANS licensees were not entitled to I-ECNS licenses under the license conversion process. Analysts said the DOC decision to appeal the court ruling granting VANS the Qsaid the DOC decision to appeal the court ruling granting VANS the right to self-provide is a major blow to the industry in South Africa. "If this appeal is upheld, it will be a sore blow for ICT competition in South Africa, which has long suffered under stifling legislation," said Huge Group CEO Anton Potgieter. He added that the policy of managed liberalization had had limited success so far, and argued that there was considerable merit in the market being allowed to take the lead in addressing the high-cost and limited service access inherent in the South African ICT industry. (Engineering News and Department of Communications Press Release, September 19-22, 2008)

Trump Enters SA Market

¶13. (U) The Trump brand of hotels and residential developments is expected to enter the South African market through a 10-year deal with local property group Devland. The joint-venture deal covers leisure, golf, and "condo-hotel" developments in South Africa and Mauritius. It is expected to create "saleable" real estate worth about R5 billion ($633 million) in the first three years. Devlan Director Neill Bernstein said "sleepy" South Africa would benefit from global creative thinkers, who could help leverage the country's property treasures. Donald Trump Jr. has been touring various projects in Gauteng and Western Cape to assess new possibilities.

Bernstein said the partnership with the Trump group had several projects in the pipeline, including eight in the Western Cape area. Trump Jr. said it was important for the Trump group to secure its branding in South Africa, which related to quality and luxury. The South African products would be marketed globally, but it was expected that 70% of the investors would be local. (Business Day, September 23, 2008)

SA and Brazil to Improve Air Connections

¶14. (U) Brazilian airline TAM is expected to announce service to South Africa by the end of 2009, following the completion of an improved bilateral agreement. The agreement grants both South

African and Brazilian airlines 14 frequencies per week between the two countries in 2008, increasing to 21 in 2009, and 28 by 2010. South African Department of Transport Air Transport Director Vuwani Ndwamato said bilateral negotiations last month improved air capacity between the two countries and lifted other traffic rights restrictions. "We have agreed on fifth freedom rights for airlines from both countries to four unnamed points, but this is restricted, in South Africa's case, to destinations outside South America, and, in Brazil's case, to destinations outside Africa," explained Ndwamato. This means both Brazilian and South African airlines would be able to pick up and drop off passengers in South Africa or Brazil respectively and travel on to destinations outside of Africa or South America. (Travel Hub, September 25, 2008)

Nationwide to Enter Full Liquidation

¶15. (U) Nationwide's liquidator Hannes Muller has confirmed that attempts to save the airline have been abandoned. Nationwide had halted service without warning in April due to soaring oil prices and the collapse of a black economic empowerment (BEE) deal. Nationwide's troubles began when an engine fell off one of its Boeing-737 on take-off in November 2007. It was cleared of fault by a Civil Aviation Authority (CAA) audit, but Nationwide was grounded at the start of the 2007 Christmas holiday season because the CAA was dissatisfied with its record-keeping on the origin of components. Nationwide was provisionally liquidated at the end of April, and months of speculation followed about potential buyers and reports that it would resurface as a low-cost domestic carrier. The airline will now go into full liquidation. (Travel Hub, September 25, 2008)

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